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DEFENSE DEPARTMENTAL REPORTING SYSTEMS  
- AUDITED FINANCIAL STATEMENTS

Report No. D-2001-165

August 3, 2001

Office of the Inspector General  
Department of Defense

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<b>Abstract</b> This audit is in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. The Chief Financial Officers Act requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards. This is the third in a series of reports related to the FY 2000 DoD Agency-Wide Financial Statements. The first report discusses the adequacy of internal controls and compliance with laws and regulations for the financial statements. The second report discusses the Financial Management Improvement Plan. The Audited Financial Statements module of the Defense Departmental Reporting System incorporates the financial statement compilation process into a single system, which allows financial statements to be shared throughout the Department of Defense community. Data from the accounting systems are transmitted to the Audited Financial Statement module of the Defense Departmental Reporting System by importing Excel trial balance spreadsheets. After the transmission, if a duly authorized official has identified any errors through analysis, reasonableness checks, or quality control procedures, a correcting journal voucher must be prepared. After all of the journal vouchers are recorded, the financial statements are produced.		
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### **Acronyms**

AFS	Audited Financial Statements
DFAS	Defense Finance and Accounting Service
OMB	Office of Management and Budget
USD(Comptroller)	Under Secretary of Defense (Comptroller)



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
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August 3, 2001

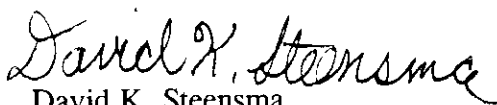
MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING  
SERVICE

SUBJECT: Audit Report on the Defense Departmental Reporting System – Audited  
Financial Statements (Report No. D-2001-165)

We are providing this report for your information and use. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Richard B. Bird at (703) 604-9102 (DSN 664-9159) (rbird@dodig.osd.mil) or Mr. Jack L. Armstrong at (317) 510-3846 (DSN 699-3846) (jarmstrong@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

  
David K. Steensma  
Acting Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

**Report No. D-2001-165**

(Project No. D2001FI-0018.004)

**August 3, 2001**

### **Defense Departmental Reporting System – Audited Financial Statements**

#### **Executive Summary**

**Introduction.** This audit is in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. The Chief Financial Officers Act requires the Inspector General, DoD, to audit the financial statements of DoD organizations in accordance with generally accepted Government auditing standards. This is the third in a series of reports related to the FY 2000 DoD Agency-Wide Financial Statements. The first report discusses the adequacy of internal controls and compliance with laws and regulations for the financial statements. The second report discusses the Financial Management Improvement Plan.

The Audited Financial Statements module of the Defense Departmental Reporting System incorporates the financial statement compilation process into a single system, which allows financial statements to be shared throughout the Department of Defense community. Data from the accounting systems are transmitted to the Audited Financial Statement module of the Defense Departmental Reporting System by importing Excel trial balance spreadsheets. After the transmission, if a duly authorized official has identified any errors through analysis, reasonableness checks, or quality control procedures, a correcting journal voucher must be prepared. After all of the journal vouchers are recorded, the financial statements are produced.

**Objectives.** Our overall objective was to determine whether the FY 2000 DoD Agency-Wide Financial Statements were presented fairly in accordance with the Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended. The specific audit objective was to determine whether the internal controls of the Audited Financial Statements module of the Defense Departmental Reporting System used to compile the DoD financial statements were adequate. We also reviewed the management control program as it related to the overall objective.

**Results.** The Defense Finance and Accounting Service made uncontrolled or unnecessary adjusting accounting entries when compiling the DoD financial statements for FY 2000. The Defense Finance and Accounting Service made \$219 billion in undocumented changes to the trial balance data before the data were imported into the Audited Financial Statements module. The Defense Finance and Accounting Service also processed 172 accounting entries valued at about \$203 billion without the appropriate levels of supervisory review. In addition, the Defense Finance and Accounting Service made accounting entries valued at \$224.7 billion to correct deficiencies in the crosswalks that place financial data on the correct financial statement line. As a result, the FY 2000 DoD Agency-Wide Financial Statements contained unreliable financial data. See the Finding section for details on the audit results.

**Summary of Recommendations.** We recommend that the Director, Defense Finance and Accounting Service, enforce existing Defense Finance and Accounting Service regulations and guidance on preparation of journal vouchers and thresholds of appropriate approval. We also recommend that the Director, Defense Finance and Accounting Service, test the entire flow of financial statement information to ensure crosswalk accuracy and to correct any identified deficiencies in the Audited Financial Statements module prior to the compilation of the FY 2001 financial statements.

**Management Comments.** The Defense Finance and Accounting Service concurred with emphasizing the need to document all accounting entries, and enforcing appropriate levels of supervisory review through the means of a warning when an accounting entry is approved by a person without the necessary authority. The Defense Finance and Accounting Service agreed to test the entire flow of accounting transactions by verifying the internal crosswalks before the FY 2001 statements were prepared. See the Finding section for a discussion of management comments and the Management Comments section for the complete text.

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## Background

This report is the third in a series of reports related to the DoD Agency-Wide financial statements for FY 2000. This report discusses the internal controls of the Defense Departmental Reporting System – Audited Financial Statements module. The first report discusses the adequacy of internal controls and compliance with laws and regulations for the financial statements. The second report discusses the Financial Management Improvement Plan.

**Reporting Requirements.** Public Law 101-576, the Chief Financial Officers Act of 1990, November 15, 1990, as amended by Public Law 103-356, the Federal Financial Management Act of 1994, October 13, 1994, requires DoD to prepare annual audited financial statements. In addition, the Federal Financial Management Act of 1994 requires the Secretary of the Treasury, in coordination with the Director, Office of Management and Budget (OMB), to prepare financial statements for all activities including Government-wide financial statements. OMB Bulletin No. 01-02, “Audit Requirements for Federal Financial Statements,” dated October 16, 2000, as revised by OMB memorandum, January 4, 2001, establishes the minimum requirements for audits of these financial statements.

**Accounting Functions and Responsibilities.** The Under Secretary of Defense (Comptroller) [USD(Comptroller)], as the Chief Financial Officer, is responsible for overseeing the preparation of agency-wide financial statements and establishing financial management policies and guidelines within DoD. The Defense Finance and Accounting Service (DFAS) performs accounting functions and prepares financial statements for DoD. DFAS, USD(Comptroller), and the DoD Components are responsible for the DoD financial statements. DFAS operates under the control and direction of the USD(Comptroller). DFAS is responsible for entering information from DoD entities into financial systems, operating and maintaining the financial systems, and ensuring the continued integrity of the information entered. DoD entities are responsible for providing accurate financial information to DFAS.

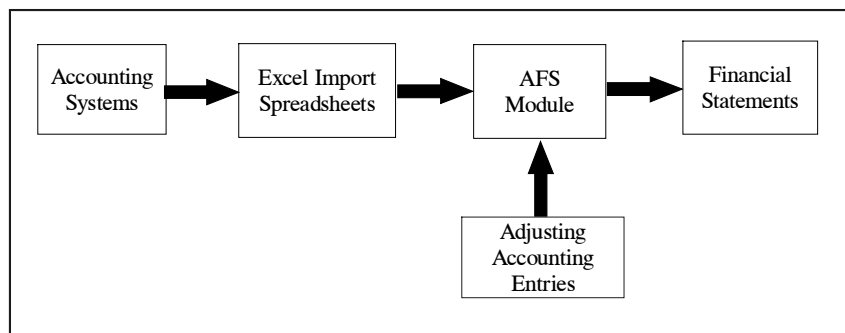
**FY 2000 DoD Agency-Wide Financial Statements.** The FY 2000 DoD Agency-Wide Financial Statements consisted of the consolidated Balance Sheet, consolidated Statement of Net Cost, consolidated Statement of Changes in Net Position, combined Statement of Budgetary Resources, and combined Statement of Financing, along with the supporting footnotes, supplementary schedules, and a management overview. The FY 2000 DoD Agency-Wide Consolidated Balance Sheet reported total assets of \$616.7 billion and total liabilities of \$1,002.8 billion as of September 30, 2000. The FY 2000 DoD Agency-Wide Consolidated Statement of Net Cost reported net program costs of about \$374.9 billion for the fiscal year ending September 30, 2000. The combined Statement of Budgetary Resources reported total program costs of about \$656.1 billion.

**Defense Departmental Reporting System.** The Defense Departmental Reporting System is a DFAS critical system under development. The system was designed to satisfy the need for a financial management system to support

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DoD's appropriation level control, financial reporting, and financial analysis. DoD began fielding the Defense Departmental Reporting System in December 1999. The Audited Financial Statement (AFS) module was the first module completed and was used to compile the FY 2000 financial statements. The AFS module is scheduled to be fully operational by September 2002. The USD(Comptroller) estimated cost to fully field the Defense Departmental Reporting System is \$27.9 million.

**Audited Financial Statement Module.** The AFS module of the Defense Departmental Reporting System incorporates the financial statement compilation process into a single system that allows financial statements to be used throughout the DFAS community. The AFS module relies on the data from accounting systems to be accurate and compliant because the module receives beginning balances and current-year transactions from those systems. For the AFS module to be populated, DFAS personnel must complete a series of steps. The following figure shows the flow of financial statement information from the accounting systems through the AFS module and to the financial statements:



#### **Flow of Financial Statement Information**

First, accounting systems convert accounting data that use the DoD chart of accounts into the U.S. Government Standard General Ledger chart of accounts with attributes. Attributes identify information that is subsidiary to the basic four-digit U.S. Government Standard General Ledger accounts. Then, each U.S. Government Standard General Ledger account is assigned to the appropriate financial statement. After that action is complete, the beginning balance data are converted to an import spreadsheet with appropriate format and file type and transmitted to the AFS module by a file transfer protocol Excel macro at the Defense Enterprise Computing Center. After transmission, if a duly authorized official has identified any errors through analysis, reasonableness checks, or quality control procedures, DFAS personnel must prepare a correcting journal voucher. After all of the journal vouchers are recorded, the financial statements are produced.

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## Objectives

Our overall objective was to determine whether the FY 2000 DoD Agency-Wide Financial Statements were presented fairly in accordance with OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended. The specific audit objective was to determine whether the internal controls of the AFS module of the Defense Departmental Reporting System used to compile the DoD Financial Statements were adequate. We also reviewed the management control program as it related to the overall objective. Appendix A discusses the scope and methodology related to the audit objectives, the management control program, and prior audit coverage.

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## **Defense Departmental Reporting System – Audited Financial Statements**

DFAS made uncontrolled or unnecessary adjusting accounting entries when compiling the DoD financial statements for FY 2000. DFAS made \$219 billion in undocumented adjustments to trial balances imported into the AFS module. DFAS personnel also made at least 172 accounting entries, valued at about \$203 billion, without the appropriate levels of supervisory review. In addition, DFAS recorded accounting entries for about \$224.7 billion to correct errors in the crosswalks that place financial data on the correct financial statement line. The errors occurred because the AFS module did not fully implement existing DFAS guidance on accounting entries. In addition, DFAS did not adequately test the financial statement crosswalks in the AFS module before fielding to determine whether the crosswalks complied with the U.S. Government Standard General Ledger. As a result, the FY 2000 DoD Agency-Wide Financial Statements contained unreliable financial data.

### **Imported Trial Balance Data**

DFAS made \$219.0 billion in undocumented adjustments to trial balances after data were imported into the AFS module. The Director, DFAS Arlington, issued a memorandum in October 1999 that provided guidance on the use and preparation of the journal vouchers. Specifically, the guidance included requirements for documenting, reviewing for accuracy, and approving journal vouchers. On August 2, 2000, the Director, DFAS Arlington, issued another memorandum that emphasized the requirements for implementing the October 1999 guidance. The Defense Finance and Accounting Service Memorandum, “Journal Vouchers Guidance,” August 2, 2000, states the following:

When the duly authorized official has identified errors through analysis, reasonableness checks, or quality control procedures, a correcting journal voucher must be prepared. Evidence to support this type of journal voucher may include a detailed listing of identified errors, narrative explaining how it is known that the original entry is incorrect, a related analysis documenting the calculation of the correct amount, and the sources of the data that were used in the analysis.

Undocumented adjustments of \$219 billion occurred because the AFS module did not fully implement existing DFAS guidance on accounting entries. DFAS made the following undocumented changes directly to the trial balance import spreadsheets.

- The Other Defense Organizations General Fund had two changes to the trial balance import spreadsheets totaling \$196.4 billion. DFAS Indianapolis personnel established beginning balances for two accounts that were new for FY 2000.

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- The Army General Fund had one undocumented change valued at \$16.7 billion to the trial balance import spreadsheet. For example, DFAS Indianapolis changed \$12.3 billion from ending equity to beginning equity.
  - The Navy Working Capital Fund had \$2.9 billion in debit and \$3 billion in credit differences between the Central Database accounting system ending trial balance amounts and the AFS module trial balance amounts. The Central Database accounting system produces department-level reports for the Navy Working Capital Fund.

Consequently, controls over the preparation of the DoD Agency-Wide financial statements were unreliable, and the FY 2000 DoD Agency-Wide Financial Statements contained unreliable data. Regardless of the origin of the change to financial data, any change should be properly documented to create an adequate audit trail. DoD Regulation 7000.14-R, "DoD Financial Management Regulation, volume 6A, Reporting Policy and Procedures," December 2000, states that DoD Components shall ensure that audit trails are maintained in sufficient detail to permit tracing of transactions with a unique identity from source to inclusion in the AFS module beginning balance.

However, not all changes made to the trial balance import spreadsheets went undocumented. Other Defense Organizations Working Capital Fund personnel documented two adjustments made to the import spreadsheets. The documentation contained an explanation, approval, and date and time. For example, Other Defense Organizations Working Capital Fund personnel prepared a journal voucher stating that prior period adjustments made by the Chief Financial Officers Team included posting errors from import sheets, reclassifying expenses, eliminating seller side entries, and balancing agency-wide statements for a total of \$2.2 billion.

Whether the change occurred in the AFS module directly or outside in one of the accounting systems, an adequate audit trail must be maintained. Import spreadsheets can be entered more than once, which allows the data to be changed without creating a journal voucher within the AFS module. This was accomplished by personnel of Other Defense Organizations Working Capital Fund, as noted above. DFAS guidance clearly states that documentation should be provided for any change made to financial statement data, regardless of origin. DFAS should fully implement the existing DFAS journal voucher guidance on preparation of adjustments.

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## Approval of Accounting Entries

DFAS personnel made at least 172 accounting entries valued at about \$203 billion that did not receive the appropriate level of review. The Defense Finance and Accounting Service Memorandum, "Journal Voucher Guidance," August 2, 2000, discusses the types of journal vouchers, when and how to use each type, the appropriate support that should accompany each journal voucher, and the approval necessary to ensure the proper entry of journal vouchers. DFAS guidance states that the approval of the journal voucher also constitutes acceptance of the supporting documentation. The following thresholds in Table 1 determine the proper approving official:

<b>Table 1. Threshold for Determining Proper Approving Official</b>	
Dollar Amount	Approving Official
Under \$100 million	Team Leaders, General Fund or Working Capital Fund Reporting Branch
\$100 - \$500 million	Chief, Procedures and Reporting, Office of Chief Financial Officer
\$500 million - \$1 billion	Entity Director for Accounting
Over \$1 billion	Entity Director

A journal voucher is approved with an electronic signature. DFAS personnel established a journal voucher approval role within the AFS module. The role has the authority to approve, disapprove, or cancel a journal voucher. DFAS personnel did not distinguish between levels of approval within the journal voucher approval role; as a result, journal vouchers were processed without the proper threshold of approval. For example, the Army General Fund contained \$155.9 billion of improperly approved journal vouchers, of which \$131.2 billion should have been approved by the Entity Director.

The adjustments occurred because DFAS personnel did not fully implement existing DFAS guidance concerning accounting entries using the AFS module. DFAS personnel did not adhere to the thresholds for determining the proper approving official established in the journal voucher guidance. For example, the Team Leader could approve a journal voucher over \$1 billion. A journal voucher should not be able to influence the financial statement data without the proper approval official's signature.

## Financial Statement Crosswalks

DFAS recorded accounting entries for about \$224.7 billion to correct errors in the crosswalks that place financial data on the appropriate financial statement line. Financial management data are to be recorded and reported as required by OMB and U.S. Treasury guidance, to provide for full financial disclosure and accountability in accordance with appropriate budget and accounting principles

and standards. As implemented in the DoD Regulation 7000.14, volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," the Treasury Financial Manual, Transmittal Letter No. S2-00-01, "U.S. Government Standard General Ledger," April 2000, establishes an agency-wide financial information classification structure of the U.S. Government Standard General Ledger to ensure consistency among report crosswalks. In May and October 2000, DFAS personnel performed tests on the AFS module, but the tests were incomplete. The data for the tests did not come from the accounting systems, as they were to be used to compile the DoD Agency-wide financial statement information. The crosswalk errors occurred because DFAS did not adequately test the flow of financial statement data from the accounting systems to the final financial statement production before the AFS module was fielded. The entire financial statement data flow needed to be tested with live data, as the data was going to be used on the financial statements. Table 2 shows the accounting entities that made adjustments and the value of adjustments made to the financial statement data because of crosswalk errors.

<b>Table 2. Adjusting Accounting Entries</b> (in billions)	
<u>Entity</u>	<u>Amount</u>
Air Force General Fund	\$ 7.7
Air Force Working Capital Fund	0.2
Army General Fund	0.7
Army Working Capital Fund	13.4
Navy General Fund	0.2
Navy Working Capital Fund	1.7
Other Defense Organizations General Fund	<u>200.8</u>
<b>Total</b>	<b>\$224.7</b>

As a result of the erroneous crosswalks, unnecessary accounting entries for about \$224.7 billion made the financial statement data unreliable. DFAS personnel should run adequate tests with live data on the entire flow of financial statement information before using new accounting systems to ensure compliance with guidelines from the crosswalk in U.S. Treasury Letter No. S2-00-01. DFAS should run these tests and correct the deficiencies before they institute year-end processing. Testing will help to reduce the number of accounting entries needed to correct errors.

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## Conclusion

DFAS made undocumented changes to the AFS module import spreadsheets by not creating a journal voucher. Regardless of the origin of the journal voucher, an adequate audit trail must be maintained. DFAS personnel also did not adhere to prescribed thresholds for determining the proper approving official established by DFAS in the journal voucher guidance. In addition, if DFAS ran tests with live data on the crosswalks before using new accounting systems, they would significantly reduce the number of accounting entries needed to correct errors. As a result, the FY 2000 DoD Agency-Wide Financial Statements contained unreliable financial data.

## Recommendations, Management Comments, and Audit Response

**Revised Recommendation.** We revised the draft Recommendation 1.a. to omit a requirement to prevent any manual changes to financial statement information into the AFS module from the trial balance and trading partner data.

**We recommend that the Director, Defense Finance and Accounting Service:**

**1. Enforce existing Defense Finance and Accounting Service guidance on the preparation of journal vouchers and the thresholds of appropriate approval as it relates to the Defense Departmental Reporting System by:**

**a. Developing specific controls to ensure that all changes to accounting data are properly documented, regardless of origin.**

**Management Comments.** DFAS concurred and stated that it would emphasize the need to ensure all changes to accounting data are properly documented, regardless of origin, in its audited financial statement training for FY 2001. The training will be held no later than September 30, 2001.

**Audit Response.** We consider the comments responsive to the recommendation and revised the recommendation to clarify our intent that DFAS develop specific controls to ensure all changes to accounting data are properly documented, regardless of origin. We revised the draft recommendation to omit “prevent manual changes to financial information into the AFS module from the trial balance and trading partner data.”

**b. Modifying the Audited Financial Statements module to contain proper internal controls that distinguish signature codes in the journal voucher approval role and associates the signature code with the proper approval level.**

**Management Comments.** DFAS concurred and stated that the AFS module will be modified to identify any journal voucher where the approving official



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normally does not have the proper approval level for the journal voucher. The necessary modification will be completed by September 30, 2001.

**2. Verify by testing the entire flow of financial statement information to ensure crosswalk compliance in the Audited Financial Statements module of the Defense Departmental Reporting System by using live data and correct any deficiencies identified in the crosswalks prior to the compilation season.**

**Management Comments.** DFAS concurred in principle but stated that most crosswalk errors were not internal to the AFS module. The centralized accounting sites will verify their internal crosswalks to the AFS module prior to the preparation of the FY 2001 financial statements. The verification will be completed prior to October 31, 2001.

**Audit Response.** The DoD AFS financial reporting cycle starts with the internal crosswalks operated by the centralized accounting sites but concludes with the AFS module. Therefore, testing of the DoD AFS financial reporting cycle must include both the centralized accounting sites and the AFS module. However, because the intent of DFAS is to verify the centralized accounting sites internal crosswalks from start to finish, we consider the comments responsive.

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## Appendix A. Audit Process

### Scope

The overall purpose was to determine whether the FY 2000 DoD Agency-Wide Financial Statements were presented fairly in accordance with OMB Bulletin No. 97-01. We reviewed the internal controls of the AFS module of the Defense Departmental Reporting System used to compile the FY 2000 DoD Agency-Wide Financial Statements. Specifically, we reviewed internal controls over the input of information in the AFS module. Also, we examined 705 of the 3,320 journal vouchers produced in the AFS module. In addition, we reviewed the adequacy of the crosswalks in the AFS module.

**Accounting Principles.** Agencies are required to follow the hierarchy of accounting principles outlined in OMB Bulletin No. 97-01, as amended. The hierarchy is as follows: standards agreed to and published by the Director, OMB, the Secretary of the Treasury, and the Comptroller General of the United States; interpretations of Statement of Federal Financial Auditing Standards issued by OMB; requirements for the form and content of financial statements outlined in OMB Bulletin No. 97-01, as amended; and accounting principles published by other authoritative sources.

**DoD-Wide Corporate-Level Government Performance and Results Act Coverage.** In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following corporate-level goal, subordinate performance goal, and performance measure:

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-02)**
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2).**

**DoD Functional Area Reform Goals.** Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

**Financial Management Area Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act of 1982. **(FM 5.3)**

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**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Financial Management high-risk area.

## Methodology

We reviewed the internal controls over the inputting of trial balance data into the AFS module. We reviewed the approval process of journal vouchers to determine whether they were properly approved and the data were fully supported. We also reviewed the adjustments that were made in the AFS module to correct crosswalk errors caused by a mapping problem from the U.S. Standard General Ledger accounts to the financial statements. We tested crosswalk data from Air Force General Fund, Air Force Working Capital Fund, Army General Fund, Army Working Capital Fund, Navy General Fund, Navy Working Capital Fund, and the Other Defense Organizations General Fund. We attended AFS module testing in May and October 2000. We conducted meetings with DFAS personnel. In addition, we reviewed applicable guidance.

**Use of Computer-Processed Data.** To achieve the audit objective, we relied primarily on computer-processed data in the AFS module of the Defense Departmental Reporting System produced by DFAS. We tested the data and determined that they were not complete. Field-level systems were not included in our review. However, when the data are reviewed in context with other available evidence, we believe that the opinions, conclusions, and recommendations in this report are valid.

**Audit Period and Standards.** We performed this financial-related audit during the period May 2000 through March 2001 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. We did our work in accordance with generally accepted Government auditing standards except that we were unable to obtain an opinion on our system of quality control. The most recent external quality control review was withdrawn on March 15, 2001, and we will undergo a new review.

**Contacts During the Audit.** We visited or contacted individuals and organizations within the DoD. Further details are available on request.

## Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Controls (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of Review of the Management Control Program.** As part of our overall objective to determine whether the DoD Agency-wide financial statements were presented fairly, we also reviewed the internal controls of the AFS module of the Defense Departmental Reporting System used to compile the

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FY 2000 DoD Agency-Wide Financial Statements. We also reviewed management's self-evaluation applicable to those controls.

**Adequacy of Management Controls.** A material management control weakness, as defined by DoD Instruction 5010.40, existed in the DFAS procedures for compiling the FY 2000 DoD Agency-Wide Financial Statements. Management controls at DFAS were not adequate to ensure that the automated processes used to compile financial statements were ready when necessary or that backup procedures were available. The control weaknesses identified and our recommendations for improvements are discussed in the Finding section. Recommendations 1.a., 1.b., and 2.; if implemented, will improve controls over the AFS module of the Defense Departmental Reporting System. A copy of the report will be provided to the senior official responsible for management controls at DFAS.

**Adequacy of Management's Self-Evaluation.** DFAS reported the general ledger and financial reporting as a material weakness, citing that the Financial Management Improvement Plan addressed system problems and fixes. The FY 2000 Financial Management Improvement Plan discloses that the Defense Departmental Reporting System is to be one of the fixes under development. The AFS module is the first part of the Defense Departmental Reporting System to be deployed. The FY 2000 Financial Management Improvement Plan did not disclose system fixes to correct the AFS material weaknesses addressed in this report. The USD(Comptroller) also acknowledged in its management representation letter for the FY 2000 DoD Agency-Wide Financial Statements that DoD financial management systems do not comply substantially with Federal accounting standards, Federal system requirements, and the U.S. Government Standard General Ledger at the transaction level.

## Prior Coverage

No prior audits have been performed on the Audited Financial Statements module of the Defense Departmental Reporting System. However, the General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>, and Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil/audit/reports>.

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## **Appendix B. Report Distribution**

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency, Financial Management, and  
Intragovernmental Relations, Committee on Government Reform  
House Subcommittee on National Security, Veterans Affairs, and International  
Relations, Committee on Government Reform  
House Subcommittee on Technology and Procurement, Committee on Government  
Reform

# Defense Finance and Accounting Service Comments



DFAS-DAS

## DEFENSE FINANCE AND ACCOUNTING SERVICE

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JUN 22 2001

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,  
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF  
DEFENSE

SUBJECT: Audit Report on the Defense Departmental Reporting System-Audited Financial  
Statements (Project No. D2001FJ-0018.004)

Our response to the subject audit is attached. The point of contact is Mr. David Arvin,  
(703) 607-2857 or DSN 327-2857.

for: *Ref. C. Bayne*  
Robert P. McNamara  
Director for Accounting

Attachment:  
As stated

cc:  
DFAS-DDI  
DFAS-AJTS/CL  
DFAS-AAB/DE  
DFAS-AX/IS

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**DFAS Comments on Audit Report on the Defense Departmental Reporting  
System-Audited Financial Statements (Project No. D2001FI-0018.004)**

**Responses to Recommendations.**

**Recommendation 1.** We recommend that the Director, Defense Finance and Accounting Service, enforce existing Defense Finance and Accounting Service guidance on the preparation of journal vouchers and the thresholds of appropriate approval as it relates to the Defense Departmental Reporting System by:

a. Developing specific controls to ensure that all changes to accounting data are properly documented, regardless of origin.

**Management Comments.** Concur. Changes to accounting data, whether reimported trial balances or journal vouchers, must be properly documented regardless of origin. DFAS will emphasize this policy in audited financial statement training for FY 2001.

**Estimated Completion Date.** September 30, 2001.

b. Modifying the Audited Financial Statement module to contain proper internal controls that distinguish signature codes in the journal voucher approval role and associate the signature code with the proper approval level.

**Management Comments.** Concur. Instances will occur when a person is temporarily acting in a capacity that provides the individual authority to approve journal vouchers of a higher value. The temporary approval level will be noted in the text of the journal voucher justification. In addition, the Defense Departmental Reporting System-Audited Financial Statements (DDRS-AFS) module will be modified to identify any journal voucher where the approver normally does not have the proper approval level for the journal voucher. This identification will be retained until the official with the proper approval level electronically approves the journal voucher.

**Estimated Completion Date.** September 30, 2002.

**Recommendation 2.** We recommend that the Director, Defense Finance and Accounting Service, verify by testing the entire flow of financial statement information to ensure crosswalk compliance in the Audited Financial Statements module of the Defense Departmental Reporting System by using live data and correct any deficiencies identified in the crosswalks prior to the compilation season.

**Management Comments.** Concur in principle. The recommendation should be rewritten to reflect that most crosswalk errors occurred in crosswalking data to DDRS-AFS input sheets and that the problem is not internal to DDRS-AFS. Additional U.S. Standard General Ledger accounts with attributes will be added to DDRS-AFS for FY 2001. The DFAS centralized sites will verify their internal crosswalks to these new DDRS-AFS accounts before the FY 2001 statements are prepared.

**Estimated Completion Date.** October 31, 2001.



## **Audit Team Members**

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

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